

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of

Developing a Unified Intercarrier
Compensation Regime

CC Docket No. 01-92

**COMMENTS OF THE PEOPLE OF THE STATE OF CALIFORNIA
AND THE CALIFORNIA PUBLIC UTILITIES COMMISSION**

GARY M. COHEN
LIONEL B. WILSON
ELLEN S. LEVINE

Attorneys for the People of the
State of California and the
California Public Utilities
Commission

505 Van Ness Avenue
San Francisco, CA 94102
Phone No. (415) 703-2047
Fax No. (415) 703-2262

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The People of the State of California and the California Public Utilities Commission (“California” or “CPUC”) hereby respectfully submit these comments in response to the Notice of Proposed Rulemaking (“NRPM”) issued by the Federal Communications Commission (“FCC”) in the above-entitled proceeding.

I. INTRODUCTION AND SUMMARY

In this NPRM, the FCC seeks to reconsider current, regulated forms of intercarrier compensation by which telecommunications carriers pay each other for interconnecting their networks. According to the FCC, it is “particularly interested in identifying a unified approach to intercarrier compensation – one that would apply to interconnection arrangements between all types of carriers interconnecting with the local telephone network, and to all types of traffic passing over the local telephone network.” NPRM ¶ 2. In particular, the FCC identifies two general intercarrier compensation regimes – access charges for long distance traffic and reciprocal compensation for local traffic – and indicates that it seeks to re-examine these regimes in light of increasing competition and new technologies, including Internet and Internet-based services and commercial mobile radio services (“CMRS”). The FCC proposes a bill-and-keep approach to fulfill its goal of a unified regime for intercarrier compensation, both for interstate access traffic and for local traffic. Specifically, bill-and-keep would govern local exchange carrier (“LEC”) recovery of costs associated with the delivery of Internet service provider (“ISP”) traffic after a three year interim period; the recovery of costs in terminating telecommunications

traffic subject to Section 251 of the 1996 Telecommunications Act (“1996 Act”); and eventually LEC recovery of interstate access charges from interexchange carriers (“IXCs”).

California respectfully submits that the NPRM elevates the theoretical goal of economic efficiency over more important rate design principles expressly reflected in the 1996 Act, notably fairness, minimization of rate shock, and reasonable allocation of joint and common costs. Based on the application of these rate design tenets, a modified bill-and-keep approach for local/ISP traffic may be reasonable. However, bill-and-keep compensation for interstate access charges would be wholly inappropriate. Such a move could result in unreasonable end user rate increases, would allow IXCs uncompensated use of LEC networks, and would be counter to Section 254(k) of the 1996 Act. In addition, the replacement of interstate access charges with bill-and-keep compensation is not needed in order to resolve arbitrage concerns and is not likely to reduce the need for regulatory intervention and oversight of termination rates. Moreover, in light of recent FCC actions regarding incumbent LEC (“ILEC”) and competitive LEC (“CLEC”) access charges and compensation for ISP-bound traffic, there is no clear need for any further access charge modifications at this time, including adoption of a forward-looking cost methodology.

II. GOALS OF INTERCARRIER COMPENSATION

The FCC seeks comment on the appropriate goals for intercarrier compensation regulations, while emphasizing that one of the main principles guiding the FCC’s reevaluation of existing intercarrier compensation schemes is economic efficiency. NPRM ¶ 31. Based on this principle, the FCC identifies what it believes to be

economically inefficient outcomes under existing intercarrier compensation schemes. The FCC then discusses why it believes that a bill-and-keep approach may minimize or eliminate such inefficiencies. In addition, the FCC cites consistency among compensation schemes as another principal goal.

California agrees that economic efficiency and consistency are certainly factors to consider in examining various intercarrier compensation regimes. However, economic efficiency should not be the sole or even paramount goal in determining whether particular regimes are just and reasonable. Indeed, the matching of marginal benefit with marginal cost is a theoretical ideal that is seldom realized in reality. The concept of cost causality is similarly theoretical and highly subjective. Likewise, the goal of consistency among intercarrier compensation regimes should not be an end in itself. As discussed more fully below, any opportunities for arbitrage resulting from different compensation regimes have been, or can be, reduced by less disruptive regulatory measures or by reliance on market forces.

The real test for determining whether and how to modify intercarrier compensation regimes is the reasonableness of the results -- i.e., the impact on end users, who ultimately pay the costs of interconnection. Thus, the goals of equity and universal service are far more important than economic efficiency or consistency in determining the viability of any given regime. Specifically, fairness, minimization of rate shock, and reasonable allocation of joint and common costs among services -- paramount principles expressly reflected in the 1996 Act -- must be effectuated by whatever compensation regime is adopted. Consistent with these principles, non-cost based revenues received through current access rates should not be transferred to end user charges. And while

penetration levels are important to consider, such levels alone are not an adequate measure of the reasonableness of charges to end users, even if universal service funding is used to reduce the impact of end user rate increases on low income customers and high cost areas.

In short, the FCC should be cautious and judicious before revising current compensation schemes in the name of economic efficiency and consistency, where such revisions result in a transfer of costs currently borne by carriers to captive, end user customers. Competing principles of fairness, maintaining affordability of telecommunications service for all, and avoiding rate shock to consumers must be heavily weighed and accounted for before theoretically “economically rational” approaches to access charges are seriously considered.

III. INTERCARRIER COMPENSATION BASED ON BILL-AND-KEEP ARRANGEMENTS

A. A Bill-And-Keep Arrangement May Be Reasonable For Local And ISP-Bound Traffic If Modified

California is not opposed to the use of bill-and-keep compensation for the transport and termination of local traffic and calls to ISPs,¹ as a general proposition.² However, in order to provide proper pricing signals, the FCC may wish to consider modifying the application of bill-and-keep in those instances when traffic is not in balance. Traffic imbalances may occur due to customers with predominantly incoming

¹ California disagrees with the FCC regarding whether calls to ISPs within the caller’s local calling area are local or interstate, but does not re-argue this issue in these comments.

² In 1995, the CPUC adopted bill-and-keep as an interim measure for local traffic governed by interconnection contracts where the LECs have not agreed to another form of compensation. Order Instituting Rulemaking on the Commission’s Own Motion Into Competition for Local Exchange Service, CPUC Rulemaking R.95-04-043, et al., Decision 95-12-056, December 20, 1995, Appendix A.

traffic or customers with large volumes of outgoing traffic. As a suggestion, it may be appropriate to consider bands on bill-and-keep, with compensation rates for out-of-balance traffic set based on an estimate of forward-looking costs of the terminating LEC. If properly implemented, such an approach could reduce any incentives for LECs to seek customers with out-of-balance traffic patterns and could reduce any adverse effect on other rates.

If the FCC adopts bill-and-keep compensation for local/ISP-bound traffic, it should not mandate that incumbent LECs be made whole in instances where bill-and-keep does not recover all of an ILEC's costs or where bill-and-keep reduces an ILEC's revenues. Apart from the authority granted to the FCC by the 1996 Act, the setting of local rates is a state matter, as the FCC has recognized. AT&T Corp. v. Iowa Utils. Board, 525 U.S. 366, 384 (1999).

The FCC seeks comment on what effect, if any, a bill-and-keep approach for traffic subject to Section 251(b)(5) would have on ILEC incentives regarding rates for unbundled network elements ("UNEs"). NPRM ¶ 68. The currently consistent methods of pricing UNEs (Section 252(d)(1)) and transport and termination (Section 252(d)(2)) provide somewhat symmetrical incentives for ILECs to maintain reasonable rates. The adoption of bill-and-keep compensation for transport and termination could remove this balance, leaving incentives for ILECs to press for higher UNE rates. While state commissions would retain the responsibility of scrutinizing the ILECs' cost studies underlying UNE rates, our jobs would be more difficult if the ILECs are excused from the consequences of having to pay as well as charge rates based on those studies. If a banded bill-and-keep regime is utilized for local/ISP-bound traffic, as discussed above,

the use of forward-looking transport and termination rates outside the bands would maintain somewhat balanced incentives as the ILECs prepare their cost studies.

B. A Bill-And-Keep Arrangement Is Not An Appropriate Replacement For Interstate Access Charges

While a version of bill-and-keep may be reasonable for local/ISP-bound traffic, the replacement of interstate access charges with bill-and-keep arrangements would be wholly inappropriate. The adoption of bill-and-keep on a make-whole basis for interstate access charges would likely result in unreasonable end user rate increases. Further, a major rationale buttressing the use of bill-and-keep for local/ISP-bound traffic—that the origination and termination of traffic is generally balanced for the interconnecting carriers—does not hold for IXC-LEC traffic exchanges. IXCs generally use the networks of LECs for both the origination and the termination of switched traffic; to allow IXCs to use the LEC networks at no cost would run counter to the principal rate design objectives discussed above, including efficiency, fairness, and rate stability.

As the FCC has recognized, the adoption of bill-and-keep for interstate access charges on a make-whole basis could lead to substantially higher flat-rated charges to end users, and could have further ramifications for high cost areas due to the resulting reduced reliance on geographic rate averaging. NPRM ¶ 123. A move to bill-and-keep for interstate access charges on a make-whole basis could transfer all revenues from interstate traffic-sensitive switched access charges to end users (except to the extent possibly diverted to universal service funding). It was estimated during the CALLS proceeding that about \$3.2 billion will remain in interstate traffic-sensitive switched access charges for price cap LECs after the targeted levels adopted in the CALLS Order

are reached. The transfer of such an amount, plus the interstate switched access revenues of non-price cap LECs, could increase end user rates by almost \$20 per line per year. This is a serious shortcoming of bill-and-keep that must not be overlooked or downplayed. If the FCC decides to adopt bill-and-keep on a make-whole basis for interstate access charges, California urges at a minimum that end user increases be capped, in order to reduce the harm to captive consumers.

California respectfully disagrees with the FCC's assumptions that access charges are above cost and subsidize universal service. NPRM ¶¶ 31-32. The exact composition of interstate access revenues has become increasingly blurred, particularly for price cap LECs. As California has pointed out previously, in addition to recovering access costs, interstate access revenues may include other components such as misallocated non-access costs (e.g., marketing costs) and excess profits. Further, the extent to which interstate access charges may still be above cost once CALLS-related changes are phased in cannot be determined absent a detailed examination of a LEC's rates and costs. California thus strongly opposes any attempt to move revenues from interstate switched access charges to end user rate elements without a full and thorough review of the composition of access charges.

Even if a comprehensive review of access charges is undertaken, switched access charges should continue to recover all costs of providing access, including a reasonable allocation of joint and common costs. Indeed, adoption of bill-and-keep for interstate access charges on a make-whole basis would violate Section 254(k) of the 1996 Act. That section expressly provides that "services included in the definition of universal service [should] bear no more than a reasonable share of the joint and common costs of facilities

used to provide those services.” If access charges were replaced with bill-and-keep compensation, basic end user rates would be forced to bear an unreasonable share of joint and common costs of the network, to the great detriment of the largely captive customers of basic universal service.³ In addition, contrary to Section 254(k), relatively non-competitive basic service would become a source of subsidy for more competitive services, such as long distance service.⁴

The FCC expresses concern about arbitrage opportunities that may arise due to differences between reciprocal compensation for ISP traffic and access charges for long distance traffic. While the FCC sees bill-and-keep as a panacea for this perceived problem, California believes that arbitrage fears are overblown and that remedies less harmful than bill-and-keep are preferable. As discussed above, a modified bill-and-keep approach may be reasonable for ISP-bound traffic. For access charges, the access charge reductions being implemented due to adoption of the CALLS proposal will significantly reduce (and possibly eliminate) the amount by which interstate traffic-sensitive access charges may be above cost. On the other hand, adoption of bill-and-keep on a make-whole basis would shield ILECs from any market pressures, whether from CLECs or from IP telephony, counter to the FCC’s goal to rely on market forces to bring about cost-based access charges.

The FCC suggests hopefully that a bill-and-keep approach could reduce or eliminate the need for regulatory intervention, including the need to set the level and structure of termination rates. NPRM ¶¶ 34 and 56. However, unless and until there is

³ Moreover, it would be inappropriate to shift to end users or the universal service fund any portion of current access revenues that contribute, for example, to excess profits.

⁴ Section 254(k) provides that carriers “may not use services that are not competitive to subsidize services that are subject to competition.”

widespread, price-constraining local competition such that end users can freely choose among alternative providers, terminating monopoly problems and the need for regulation of termination rates will remain. Transferring the recovery of termination costs from carriers to end users will only modify the focus of regulation, not eliminate it. Federal regulation of end user termination charges could prove to be even more problematic than regulation of terminating access charges.

The FCC seeks comment on how a bill-and-keep regime for carrier access charges would affect existing separations rules. NPRM ¶ 122. Adoption of bill-and-keep for interstate access charges would not justify separations changes. A reasonable portion of joint and common costs must still be allocated to the interstate jurisdiction, regardless of how the FCC chooses to set interstate rates.⁵ In addition to the concerns already raised regarding bill-and-keep, California opposes any attempt by the FCC to transfer jurisdictionally interstate costs to the States.

The FCC also seeks comment on intercarrier compensation for LEC-CMRS traffic. An assessment of the desirability of bill-and-keep for LEC-CMRS compensation should consider the same factors discussed above. To the extent that LEC-CMRS traffic flows are not in balance, with more traffic terminating on the landline networks, bill-and-keep with make-whole provisions could subsidize CMRS at the expense of basic end user customers. California would oppose such an outcome.

IV. ALTERNATIVES IF BILL-AND-KEEP IS NOT ADOPTED

The FCC seeks comment on whether it should adopt a forward-looking cost methodology for both access and reciprocal compensation, if it does not adopt bill-and-

⁵ Smith v. Illinois Bell Telephone Co., 282 U.S. 133, 148-49 (1930).

keep. NPRM ¶ 99. In these comments, California has suggested a modified bill-and-keep approach for local/ISP-bound traffic as possibly more appropriate than a pure bill-and-keep regime. While a forward-looking cost methodology for access charges may be less disruptive to end users than bill-and-keep, the FCC should not adopt forward-looking economic costs for interstate access charges, or make other changes to access charges, without full consideration of the rate design issues discussed above, with the central focus being the reasonableness of the resulting changes to end user rates.

The FCC has already taken steps to reduce access charges for price cap LECs, and is contemplating changes for non-price cap LECs in the MAG proceeding. It has addressed terminating monopoly concerns in the CLEC Access Charge Order. Until it can be determined whether the resulting balance between intercarrier and end user rates works reasonably well, there is no clear need for further modifications such as the FCC is proposing.

V. JURISDICTIONAL ISSUES REGARDING CMRS-LEC INTERCONNECTION

In its NPRM, the FCC seeks comment on the relationship between state and federal authority over CMRS interconnection in light of Sections 201, 251, 252 and 332 of the Communications Act. NPRM ¶ 86. In particular, the FCC seeks comment “on the extent to which section 332 preempts state regulation of intrastate LEC-CMRS interconnection and gives such authority to the (FCC).” NPRM ¶ 87.

Section 332 (c)(1)(B) provides that the FCC shall, upon reasonable request of a CMRS provider, order a common carrier to physically connect with the CMRS provider pursuant to Section 201. However, by its terms, Section 332(c)(1)(B) makes clear that the FCC’s authority to order such physical connections is not to be construed as a

limitation or expansion of the FCC's pre-existing authority under Section 201. Under Section 201, the FCC has authority to direct common carriers to establish physical connections with other carriers but only with respect to "common carriers engaged in *interstate or foreign* communication by wire or radio." Section 201(a) (emphasis added).

Section 332(c) also specifies the scope of state authority over CMRS providers. Under Section 332(c)(3), states are precluded from regulating "the entry of or the rates charged by any commercial mobile service" provider. The "rates charged by any commercial mobile service" provider are the retail rates paid by end users for services offered by CMRS providers themselves. They are not the wholesale rates charged by a common carrier (i.e., by an ILEC) to the CMRS provider for interconnection. This distinction is reflected in the language of Section 332(c)(3)(A)(i) and the legislative history of Section 332(c)(3). In Section 332(c)(3)(A)(i), Congress provided that, notwithstanding the preemptive language of Section 332(c)(3), a state may petition the FCC for authority to regulate the rates for any commercial mobile service if the state demonstrates that "market conditions with respect to such services fail to protect subscribers adequately from unjust and unreasonable rates, or rates that are unjustly or unreasonably discriminatory."⁶ In Section 332(c)(3)(B), Congress grandfathered existing state regulation "concerning the rates for any commercial mobile service offered in such State" for a specified time. In addition, Congress provided that if the FCC grants a state petition for continued rate regulation, the FCC shall authorize the state to exercise authority over "rates for commercial mobile services" for so long as necessary. Each of

⁶ Alternatively, the state must demonstrate that "such market conditions exist and such service is a replacement for land line telephone exchange service for a substantial portion of the telephone land line exchange service within such State." Section 332(c)(3)(ii).

these clauses within Section 332(c)(3) makes clear that Congress focused on retail rate regulation, and meant to preempt state authority only over the rates charged by commercial mobile service providers for services offered by such providers.

The savings clause of Section 332(c)(3)(A) and its legislative history confirm this construction. Section 332(c)(3)(A) states that “this paragraph shall not prohibit a State regulation the other terms and conditions of commercial mobile services.” The legislative history of this section clarifies Congress’ intent to construe “terms and conditions” broadly to include “the requirement that carriers make capacity available on a wholesale basis” – which necessarily includes the prescription of wholesale rates for network capacity that can be utilized by competing carriers.

The 1996 Act did not alter the scope of Section 332(c)(1)(B) nor otherwise expand the FCC’s authority thereunder. See Section 601(c) (the 1996 Act “shall not be construed to modify, impair or supersede Federal, State, or local law unless expressly so provided in such Act or amendments.”) To the contrary, the 1996 Act reaffirmed the states’ authority to establish the actual wholesale interconnection rates for carriers offering local service in competition with an incumbent carrier. In Section 251 and 252 of the 1996 Act, as construed by the U.S Supreme Court in AT&T Corp. v. Iowa Utils. Board, the FCC may adopt pricing standards for interconnection, but it is the states that determine the actual rates. Id. at 384.⁷

⁷ The Eighth Circuit’s decision in Iowa Utils. Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997), aff’d in part and remanded, AT&T Corp v. Iowa Utils. Bd., 525 U.S. 366 (1999), does not support a construction that gives the FCC plenary authority over all CMRS rates. In footnote 21, the Eighth Circuit upheld certain federal pricing rules governing the interconnection of LECs and CMRS providers. 120 F.3d at 800 n.21. The Eighth Circuit did not, however, conclude that the states played no role whatsoever in setting interconnection rates governing LEC-CMRS. Under AT&T Corp. v. Iowa Utils. Board, at a minimum, states would continue to exercise authority to set the actual rates for interconnection service.

In sum, Section 332(c) and relevant sections of the 1996 Act do not preempt the states' authority to set interconnection rates between LECs and CMRS providers.

VI. CONCLUSION

For the reasons discussed herein, California does not oppose the application of a *modified* bill-and-keep approach for local/ISP-bound traffic. California does, however, strongly oppose bill-and-keep compensation for interstate access charges as contrary to the express provisions of the 1996 Act, contrary to well-established rate design principles of fairness and minimization of rate shock reflected in the 1996 Act, and unnecessary to address concerns regarding arbitrage or degree of regulatory intervention.

Respectfully Submitted,

GARY M. COHEN
LIONEL B. WILSON
ELLEN S. LEVINE

/s/ ELLEN S. LEVINE

Ellen S. LeVine

Attorneys for the People of the State
of California and the California
Public Utilities Commission

505 Van Ness Avenue
San Francisco, CA 94102
Phone No. (415) 703-2047
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